

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MOTION MARKETING ASSOCIATES, INC.	:	DETERMINATION
T/A ON TARGET AND	:	
SHELDON DANUFF	:	
AND IRVING SIEGAL, OFFICERS	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period June 1, 1983	:	
through November 30, 1986.	:	

Petitioners, Motion Marketing Associates, Inc. t/a On Target and Sheldon Danuff and Irving Siegal, officers, P.O. Box 1400, Westbury, New York 11590, filed a petition for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1983 through November 30, 1986 (File No. 805977).

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 10, 1990 at 9:45 A.M., with all briefs to be filed by August 31, 1990. Petitioners appeared by Isaac Sternheim & Co. (Isaac Sternheim, C.P.A.). The Division of Taxation appeared by William F. Collins, Esq. (Irwin A. Levy, Esq., of counsel).

ISSUES

I. Whether it was proper to preclude the Division of Taxation from challenging the adjustments which were made to the assessments by a conciliation conferee.

II. Whether petitioners' receipts were derived from the sale of advertising services resulting in petitioners' purchases being subject to sales tax, or whether petitioners' receipts were derived from the sale of tangible personal property and thus subject to sales tax.

III. If petitioners' purchases are subject to tax, whether the Division properly assessed tax on petitioners' purchases of cartons, mailing labels and other packaging materials.

IV. Whether penalties and interest in excess of the minimum, which were imposed against petitioners, should be waived.

FINDINGS OF FACT

On May 12, 1986, the Division of Taxation ("Division") commenced an audit of petitioner Motion Marketing Associates, Inc. t/a On Target ("On Target"). On this date, an auditor met with On Target's controller and discussed the impending audit.

The auditor learned that On Target was a company which produced and mailed coupons. The coupons offered discounts or other inducements to patronize a party's business. On occasion, the inducements included merchandise such as plastic bags, American flags, shoe stretchers and plungers.

On Target's activity consisted of placing coupons, and perhaps a flyer, into an envelope and then mailing the item. The actual printing of the coupons was done by a sister corporation known as Getting to Know You ("GTKY").

In its brochure, On Target described its activities as follows:

"The complete Direct Mail Advertising company with on-premises facilities for art, typography, composition, printing, collating, inserting and computerized list management."

The order form used by On Target was entitled "On Target Advertising Order". It described On Target's customer as the advertiser.

On the first day the auditor visited On Target's premises, she left a letter which scheduled an audit appointment. The letter requested an opportunity to review On Target's books and records including ledgers, invoices, tax returns and other documents pertaining to On Target's sales tax liability.

When the auditor first visited On Target's premises, she found that On Target was located in a large rectangular building which contained printing equipment as well as desks, telephones and clerical staff. On Target shared the premises with GTKY.

On June 20, 1986, the auditor went to On Target's premises and transcribed certain preliminary information. The auditor found that it was On Target's practice to collect sales tax

on its sales. Generally, On Target charged a rate of \$64.00 per 1,000 mailings. Rather than collecting sales tax on its gross sales, it was On Target's practice to collect tax at a rate of \$3.00 per 1,000 coupons sold regardless of both the tax rate of the jurisdiction where On Target's customer was located and the actual charge for the coupons. The auditor also found that On Target remitted those taxes which it collected.

After making an inquiry to Division personnel in Albany, New York, the auditor informed On Target that the Division's position was that On Target was engaged in advertising and that all of its expenses would be held taxable. Thereafter, the auditor requested On Target's expense records and transcribed the amounts listed for the month of November 1985. Through this process, the auditor sought to determine if the amounts in the expense records were reported in the general ledger.

The auditor found an entry called production costs which was entered once a year in January. When asked what this amount represented, On Target responded that: "Production costs are entered once a year in January for the prior year. Production costs are the payroll costs to produce the printed coupons, to mail them, to do the artwork, delivery, warehousing, et cetera." On Target also explained that: "All employees are on GTKY, Getting to Know You, payroll. GTKY is an affiliate corporation that shares the premises and has the same corporate offices as Motion Marketing Associates has."

Upon receiving the foregoing explanation, the auditor requested that On Target furnish its purchase records. This request was refused because On Target felt that it was selling tangible personal property and therefore its tax liability should not be premised upon its purchase records.

In order to calculate the amount of tax due, the auditor determined that tax was due on the amounts recorded in the general ledger for printing, mailing, production costs and office stationery for the period June 1983 through November 1986. This resulted in tax due of \$233,417.00. The auditor also concluded that tax was due in the amount of \$3,596.57 on the purchase of certain equipment. Petitioner had not paid sales tax on the machinery on the basis

of its position that it was producing tangible personal property for sale. Therefore, On Target regarded its purchase of machinery as exempt from tax. Lastly, the Division imposed omnibus penalties for the periods beginning June 1, 1985 because the amount of tax found due was more than 25% of the amount of tax which had been remitted.

On the basis of the foregoing audit, the Division issued two notices of determination and demands for payment of sales and use taxes due, dated June 20, 1987, to Motion Marketing Associates, Inc. t/a On Target. One notice assessed tax for the period June 1, 1983 through November 30, 1986 in the amount of \$237,013.35, plus penalty of \$56,783.69 and interest of \$66,127.19, for a total amount due of \$359,924.23. The Division also issued a notice to On Target which assessed a penalty in the amount of \$10,651.86 for the period June 1, 1985 through November 30, 1986. On the same date, the Division issued notices of determination and demands for payment of sales and use taxes due to Sheldon Danuff and Irving Siegal, as officers of On Target. The notices assessed the same amount of tax, penalty and interest which had been assessed against On Target.

After the foregoing assessments were issued, On Target filed a petition. On January 5, 1988, the matter was scheduled for a conciliation conference before the Bureau of Conciliation and Mediation Services. On the basis of the Chartair decision,¹ the conferee directed the auditor to return to On Target's place of business to examine in detail the printing and mailing accounts for November 1985. After a review of these accounts, the auditor determined that printing was 99.85% taxable and that mailing was 88.62% taxable. Thereafter, the conferee directed that these percentages be applied to the month of November 1985 and that the tax liability be limited to the amount found due for that month alone. The conciliation conferee's decision effected the following reduction:

	Original Amount	Revised <u>Amount</u>
Printing		\$ 6,954.00

¹See, Matter of Chartair, Inc. v. State Tax Commn. (65 AD2d 44, 411 NYS2d 41).

Mailing	12,076.00	109.00
Production	55,783.00	55,783.00
Office Supply	<u>2,475.00</u>	<u>2,475.00</u>
	\$233,416.00	\$65,321.00

When the auditor calculated the taxable percentage in the mailing account, she inadvertently failed to give On Target credit for two items, in the respective amounts of \$210.68 and \$75.78, upon which tax was paid.

The auditor strenuously disagreed with the adjustments made at the conciliation conference. In furtherance thereof, the auditor filed an internal form seeking a review of the conferee's decision. Although the record is not completely clear, it appears, on review, that the conferee's decision was upheld.

On Target does not sell space on a coupon. Rather, it charges customers based on its sales of groups of a thousand coupons. On Target's customers pay one price, per thousand coupons, which covers all expenses including postage. On Target does not pay tax on the production equipment, paper or any related matter on the basis of its position that it is making purchases for resale.

One of the items which was found taxable during the examination of the printing account was an expense of \$24,794.82 from Tri-Boro Carton Company, Inc. in Brooklyn, New York. The expense was for the purchase of boxes which On Target bought to distribute the books of GTKY and its franchisees. The containers would be shipped to On Target's plant in Westbury, New York where they would be combined with books. Thereafter, the books would be shipped to individuals who were the targets of GTKY's advertising or in bulk to franchisee's of GTKY which were in California and along the eastern seacoast.

The only equipment which On Target has is a machine which places coupons in envelopes. All employees of Motion Marketing are on the payroll of GTKY. Therefore, in order to allocate expenses, an annual journal entry was made to allocate the cost of the premises, labor and equipment. Through this journal entry, all of the profit was allocated to GTKY because this was the corporation that had the lines of credit and the franchises.

SUMMARY OF THE PARTIES' POSITIONS

At the outset of the hearing, the Division sought to raise the issue of whether the conciliation conferee's decision should be vacated and the original assessment sustained. The Division premised this argument on the basis that On Target did not maintain adequate books and records and therefore the Chartair decision was improperly applied. Under these circumstances, the Division was precluded from raising the issue at the hearing.

On Target maintains that its expenses are not subject to tax and that it properly collected tax on its sales of coupons. On Target also argues that even if its expenses were subject to tax, the annual entry for production costs would be exempt from tax. On Target further argues that if purchases are subject to tax, the tax should not be assessed on the costs for the cartons, mailing labels and packaging materials. Lastly, On Target argues that it properly attempted to report and pay tax on the basis that its sales were taxable. Therefore, it is argued that penalty should be abated.

CONCLUSIONS OF LAW

A. The regulations of the Bureau of Conciliation and Mediation Services are set forth at 20 NYCRR part 4000. These regulations provide at 20 NYCRR 4000.5(c)(4) as follows:

"In the absence of a showing of fraud, malfeasance or misrepresentation of a material fact, such order will be binding on the Division of Taxation and the requester. However, a conciliation order will not be binding on the requester if such person petitions for a hearing concerning the statutory notice within 90 days after the conciliation order is issued. The petition must be filed in accordance with section 3000.3 of this Title."

B. As previously noted, the Division has not alleged that the conferee's decision was effected by fraud, malfeasance or misrepresentation of a material fact. Since these are the only grounds upon which the Division may challenge a conferee's decision, the conciliation order is binding on the Division.

There is a second factor which supports this conclusion. To have permitted the Division to argue that the original assessment should be reinstated would have put On Target in an untenable position at the hearing. Since On Target challenged the assessment as adjusted at conference, it would not have had any notice that the original assessment was being litigated.

Accordingly, for both of the foregoing reasons it was proper to preclude the Division from raising the issue of whether the original assessment should be reinstated.

C. The next question presented is whether On Target is selling tangible personal property in the form of coupons or whether the essence of On Target's business consists of providing an advertising service. There does not appear to be any question that On Target does have printing performed for its customers. However, this is not the limit of On Target's activity. On Target's own brochure describes its customers as advertisers. On Target's description of its services in its brochure is also instructive.² On Target holds itself out as an advertising firm which provided, among other things, art and composition. In view of the range of services provided, it is clear that On Target is performing an

advertising service and the provision of the coupons is incidental to the service which it provided. Since On Target is performing an advertising service, its purchases of materials for use in performing its services are considered purchases at retail which are subject to sales tax (20 NYCRR 527.3[c][2]).

D. On Target next argues that tax should not have been assessed on the purchase of cartons, mailing labels and other packaging materials. Presumably, this argument is premised, in part, on the fact that some of the packaging material was shipped out of state. This argument is without merit. The assessment is premised upon the tax due on On Target's purchases and not its sales. Therefore, the location of the ultimate recipient of the cartons is irrelevant.

In its brief, On Target argues that the mailing charges were not taxable because a predetermined amount of sales tax was collected from the retailer. This argument must also be rejected. As previously stated, since the tax is being imposed on the purchase, the fact that tax was factored into the sale price is also irrelevant.

It is recognized that there is an exemption for packaging materials set forth at Tax Law

²Although the use of the term advertising is not determinative, On Target's description of its own services cannot be disregarded.

§ 1115(a)(19). Specifically, this section provides that receipts from the following are exempt from sales tax:

"Cartons, containers, and wrapping and packaging materials and supplies, and components thereof for use and consumption by a vendor in packaging or packing tangible personal property for sale, and actually transferred by the vendor to the purchaser."

Here, there is no evidence as to the amount which is transferred to the purchaser as opposed to the target of the advertising. Therefore, this section is inapplicable.

E. On Target is correct that the intercompany allocation of labor and overhead is not subject to sales and use taxes. Therefore, sales and use taxes should not have been assessed on the annual entry on the account labeled production costs.

F. On Target's last argument is that the penalty should be abated. In this regard, On Target argues that there was no attempt to misrepresent the amount of tax due and that it was reporting tax on the basis of its operations representing the sale of tangible personal property.

On Target's request to abate penalty is denied. Such penalties may only be remitted if the taxpayer can establish that the failure to comply with the Tax Law was due to reasonable cause and not due to willful neglect (20 NYCRR 536.5[a]). Here, even if one accepts the premise that On Target believed that it was correct to collect tax on its sales, there is no showing that On Target made a reasonable effort to collect the correct amount of tax. The record shows that On Target collected tax based on the quantity of coupons sold rather than on its actual receipts. Further, there was apparently no attempt to take into account the different tax rates of the jurisdictions with which On Target did business. Therefore, even if one were to accept On Target's original reporting position, it cannot be said that On Target's failure to comply with the Tax Law was due to reasonable cause and not willful neglect.

G. In view of the error noted in Finding of Fact "14", the Division is directed to make an appropriate adjustment to the notices of determination and demands for payment of sales and use taxes due.

H. The petition of Motion Marketing Associates, Inc. t/a On Target and Sheldon Danuff and Irving Siegel, officers, is granted to the extent of Conclusions of Law "B", "E" and "G" and

the Division is directed to modify the appropriate notices of determination and demands for payment of sales and use taxes due accordingly; except as so granted, the petition is otherwise denied and the notices of determination and demands for payment of sales and use taxes due are sustained.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE